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May 7, 1998

Mr. Richard Metzger
Chief, Common Carrier Bureau
Federal Communications Commission
Room 500
1919 M Street, N.W.
Washington, D.C. 20554

Re: EX PARTE in Access Charge Reform, CC Docket No. 96-262 Consumer Federation of America, International ; Communications Association and National Retail Federation Petition Requesting Amendment of the Commission's Rules Regarding Access Charge Reform and Price Cap Review for Local Exchange Carriers, RM 9210

Dear Mr. Metzger:

One year ago, the Commission adopted the Access Reform Order, the third part of "a trilogy of actions intended to foster and accelerate the introduction of competition in all telecommunications markets." The Commission recognized that interstate access charges were significantly above their forward-looking cost levels, and that these inflated access charges suppressed demand for interstate interexchange services, impeded the efficient development of competition in the local and long distance markets, and retarded economic growth.

To address the inflated level of access charges, the Commission selected a "market-based" approach to access reform. The Commission's choice of the "market-based" approach was based on its prediction that substantial competitive entry into the local services market would occur and that this competitive entry would quickly exert downward pressure on incumbent local exchange carrier (ILEC) access charges. The Commission believed that "[t]he 1996 Act removes barriers to entry in the local market, generating competitive pressures that make it difficult for incumbent LECs to maintain access charges above economic cost."

Judged by its impact on the level of interstate access charges, the Access Reform Order has been a nonevent. One year after the adoption of the Access Reform Order, the incumbent LECs are still pricing at the maximum allowed by the price cap rules. Interexchange carriers still have no viable alternative to ILEC access services, and continue to pay the ILECs interstate access charges that are approximately $10 billion above forward-looking economic cost. These inflated access charges continue to suppress demand for interstate interexchange services, impede the development of efficient competition, and retard economic growth.

With this letter, MCI submits to the Commission a report on competition in the exchange access market that shows why ILECs have had absolutely no reason to reduce access charges. The report confirms that exchange access markets remain the dominion of the incumbents, and that the very limited presence of facilities-based competitors has failed to produce downward price pressure that the Commission anticipated when it adopted its Access Reform decision. New entrants have been limited to facilities construction as a mode of entry. Because facilities-based network construction is slow and capital intensive, competitive local exchange carrier (CLEC) networks reach only a fraction of the buildings served by ILEC networks. With such limited network reach, CLECs receive less than 1 percent of the nation's switched access revenues. ILECs have no incentive to respond to such minimal levels of competitive entry.

Even MCI, which has spent $2 billion entering local markets, is currently operating in 31 cities, has proposed a merger with WorldCom in an effort to expand its market reach to approximately 100 cities on the day of the merger, and which long ago adopted a corporate policy of diversifying access vendors, has been stymied in its attempts to find and exercise competitive choice for its own exchange access arrangements. Despite all of these aggressive market-opening actions, over 99 percent of MCI's originating access minutes today are delivered by ILEC networks.

Faced with this overwhelming empirical evidence, the Commission must immediately reopen the access reform debate to prescribe rates to their economic cost levels. Competition is having no effect on the pricing habits of ILECs, who continue to charge at price cap maximums. With no prospect that the amounts by which access is above cost will be eroded by competitive pressures, the Commission's legal obligation, and its obligation to act in furtherance of Congressional policy favoring competition in all telecommunications markets, is to use its prescriptive power to remove what can only be charitably characterized as an implicit subsidy to the ILECs and their shareholders.

I. Market Data Demonstrates that the Exchange Access Market Is Not Subject to Competition

The Commission's adoption of the market-based approach was based on its prediction that the policies of the Telecommunications Act would "greatly facilitate" competitive entry into the provision of all telecommunications services, including interstate access. In particular, the Commission cited the 1996 Act's cost-based pricing requirement for interconnection and unbundled network elements (UNEs). The fundamental assumption underlying the Commission's choice of the market-based approach was that unbundled network elements could provide a "ubiquitous substitute for access services."

The attached report of switched access competition shows that UNEs have been far from a "ubiquitous" substitute for access services. One year after the adoption of the Access Reform Order, and almost two years after the adoption of the Local Competition Order, CLECs offering commercial service have been limited to using their own facilities or, to a limited degree, their own facilities in combination with ILEC loops. Unbundled loops as a service delivery method account for less than 0.1 percent of Regional Bell Operating Company (RBOC) and GTE access lines: of a total of 144.5 million access lines, only 123,680 have been sold to CLECs as unbundled elements. As a measure of how insignificant this figure is, the RBOCs and GTE are expected to add *6 million* access lines between 1997 and 1998.

Facilities-based entry has no chance of exerting competitive pressure on ILEC access charges in the foreseeable future. Because of the capital-intensive nature of facilities construction, CLEC networks simply do not have the necessary reach to compete. CLEC transmission facilities are less than 1/1000th of ILEC total transmission facilities, and CLEC networks are connected to at most 0.33 percent of the nation's commercial buildings and virtually no residential buildings.

The market share data in the report confirms that the situations in which CLECs using their own facilities can provide an alternative to ILEC switched access are extremely limited. Despite the best efforts of IXCs to find competitive alternatives, ILECs are still originating over 99 percent of MCI's switched access minutes in most states. As a result, the ILECs' interstate switched access revenues of $28 billion continue to dwarf the CLECs switched access revenues, which are at most $400 million.

II. The Commission Must Reduce Access Charges With Prescriptive Measures

Since the Commission adopted the Access Reform Order, the 8th Circuit has struck down the Commission's pricing guidelines for unbundled network elements and the Commission's requirement that ILECs combine unbundled network elements for new entrants. (Although we expect this decision to be reserved by the Supreme Court, the impact of the decision has been -- and continues to be -- clear: it removes the theoretical foundation on which the Commission's access-charge order was based.) Without a requirement that the ILECs combine network elements, the scope for UNE-based competition is sharply reduced. As the Commission concluded in the Local Competition Order, "requesting carriers would be seriously and unfairly inhibited in their ability to use unbundled elements to enter local markets" if the ILEC is not required to combine elements. The availability of the "platform" strategy was an important factor underlying the Commission's "confidence" that unbundled elements could be counted on to constrain the pricing of access services. While some state commissions have boldly embraced forward-looking economic pricing even in the wake of the 8th Circuit's ruling, final pricing remains an open issue in many jurisdictions, and new entrants with national aspirations, such as MCI, are today faced with the prospect of having to "prove in" the cost of entering local markets on a state-by-state, instead of regional, basis.

Without UNEs priced at forward-looking economic cost and available in combinations, the Commission can no longer reasonably predict that competition will evolve sufficiently to reduce interstate access charges. In the Access Reform Order, the Commission stated that it would explore using prescriptive measures if competition failed to develop. Facilities-based network construction, the only viable local entry strategy, is too slow to have any impact on the level of interstate access charges between now and 2001, the year the Commission indicated it would review its access reform plan. Today, one quarter of the way to the year 2001 "checkpoint," the competition odometer has barely flickered. There is no prospect of cost-based access charges by the year 2001. Only a prescriptive approach can achieve the Commission's goal of driving interstate access charges to cost.

The continuation of above-cost access charges, without prospect for change, is both unlawful and contradicts Congressional policy favoring competition in all telecommunications markets. Congress outlawed implicit subsidies. But hidden subsidies continue to exist under the guise of access charges. During 1998, the Commission is expected to complete work on its universal service reform effort to maintain "affordable" local rates. The Commission's statements in the Access Reform Order that its policies would promote lower access rates -- statements made in advance of a decision to size the universal service subsidy -- reject the most extreme of ILEC views that current ILEC revenue streams must be preserved in their entirety for universal service purposes. In any event, sizing of the universal service fund will remove the last fig leaf from the ILEC access charge debate. Any amounts above and beyond what are identified for universal service subsidy are nothing more than an unlawful and implicit subsidy for ILECs and their shareholders.

Interstate access charges must be reduced to forward-looking economic cost. As the Commission found in the Access Reform Order, inflated access charges distort competition in the interexchange market. Inflated access charges suppress demand for interexchange services and permit ILECs providing interexchange services to implement a price squeeze. Inflated access charges also constitute a barrier to entry in the local exchange market because they constrain the financial resources available for interexchange carriers to enter local markets. Reducing interstate access charges to forward-looking economic cost would unquestionably increase consumer welfare.

The Commission must immediately initiate a rulemaking to prescribe interstate access charges to forward-looking economic cost. Immediate prescription of interstate access charges to forward-looking economic costs is clearly in the public interest; as was also pointed out by the Consumer Federation of America, International Communications Association and National Retail Federation in their Petition Requesting Amendment of the Commission's Rules Regarding Access Charge Reform and Price Cap Review For Local Exchange Carriers, filed on December 9, 1997.

Sincerely,

Mary L. Brown

Mary L. Brown

ABSENCE OF COMPETITION
IN
THE EXCHANGE ACCESS MARKET

May 7, 1998

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I. Introduction

The Telecommunications Act of 1996 promised that the local markets monopolized by incumbent local exchange carriers ("ILECs") would be opened to competition, resulting in huge welfare gains.[1] One year ago, the Commission adopted the Access Charge Reform Order,[2] the third part of "a trilogy of actions intended to foster and accelerate the introduction of competition in all telecommunications markets." The Commission recognized in that Order that interstate access charges were significantly above their forward-looking cost levels, and that these inflated access charges suppressed demand for interstate interexchange services, impeded the efficient development of competition in the local and long distance markets, and retarded economic growth.

To address the inflated level of access charges, the Commission selected a "market-based" approach to access reform. The Commission's choice of the "market-based" approach was based on its prediction that substantial competitive entry into the local services market would occur. This competitive entry in local markets would simultaneously provide competition for exchange access services with the anticipated result of downward pressure on incumbent local exchange carrier (ILEC) access charges. The Commission believed that "[t]he 1996 Act

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1 Pub. L. No. 104-104, 110 Stat. 56 (codified throughout 47 U.S.C.) (the "Act," "1996 Act," or "Telecommunications Act").

2 Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing , End User Common Line Charges, CC Docket Nos. 96-262, 94-1, 91-213, and 95-72, First Report and Order, FCC 97-158 (rel. May 16, 1997)(Access Charge Reform Order).

removes barriers to entry in the local market, generating competitive pressures that make it difficult for incumbent LECs to maintain access charges above economic cost."

Congress intended the 1996 Act to open local monopolized markets to competition, benefiting consumers through lower prices, improved quality and service, and technological innovation. But the capital-intensive and time-consuming effort required to deploy competitive local telecommunications facilities, coupled with ILEC anticompetitive and litigious conduct, means that the prospects for widespread local exchange competition in the near future are bleak. Now, more than two years after the Act's passage -- and despite MCI's investment of over $2 billion dollars in local markets -- there has been little of the local competition that is the Act's primary goal, and interstate access rates remain approximately $10 billion above forward-looking economic cost.[3]

The inflation of access charges can be measured in other ways. In addition to cost models that provide measures of forward-looking cost, it is also possible to use cash flow as an indicator of the inflation of access rates above cost. Today, ILECs are receiving nearly a 70 percent cash flow from access charges -- a level unmatched by any other segment of the telecommunications business. By comparison, ILEC cash flow on their local operations is slightly over 20 percent.[4]

The ILECs continue to dominate their balkanized local exchange and exchange access markets. Data on file at the Commission demonstrated that before passage of the Act, ILECs

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[3] Current ILEC access charges equal about 2.4 cents per access minute. HAI 5.0a estimates switched access cost at approximately 0.4 cents per minute. Multiplying the difference by total interstate switched access minutes yields approximately $10 billion.

[4] See Appendix A.

controlled 99.6% of local exchange services, 97% of local private line services, 97.5% of other local services, and 98.5% of interstate and intrastate access services.[5] Those conditions have not changed significantly since passage of the Act.

Today, competitive local exchange carriers (CLECs) account for approximately 1.4 percent of total switched access revenues.

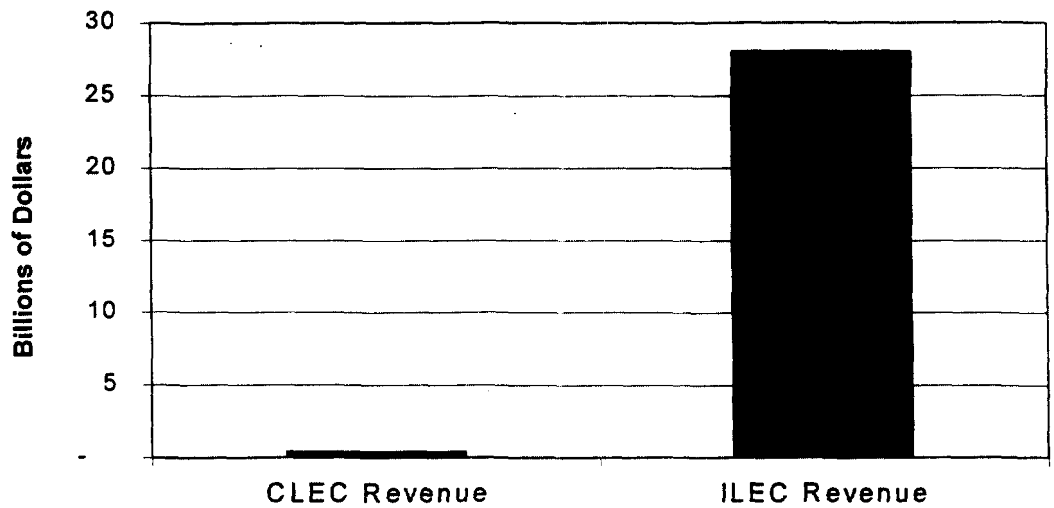
Table 1. ILEC and CLEC 1997 Access Revenues[6]

(Billions of dollars)	Switched Access	Special Access	Total Access
ILEC Revenue	28.0	5.90	33.90
CLEC Revenue	0.4	1.35	1.75
CLEC Percent	1.4%	18.6%	4.9%

5 Evaluation of the U.S. Department of Justice, SBC Communications-Oklahoma, May 16, 1997 at 4 n.7 ("SBC Evaluation") (citing Federal Communications Commission, Telecommunications Industry Revenue: TRS Fund Worksheet Data at Table 2 (Dec. 1996)).

6 ILEC data from 1998 Annual Report on Local Telecommunications Competition, 9th Edition, New Paradigm Resources Group, Inc, Chapter 4, Table 5, at 8. CLEC data from MCI market research.

Table 2. 1997 CLEC/ILEC Market Share by Switched Access Revenue



Competition for ILEC service has primarily emerged for high capacity (DS1 and DS3) transport services only in ILEC "zone 1" or higher traffic areas. As a result, CLEC activities have placed limited competitive pressure on less than 6.4 percent ($845 million) of ILEC access revenues.

Table 3. 1997 ILEC Access Revenue at Risk from CLEC Activities[7]

Access Charges Paid by IXCs to ILECs	13,201,026,934
Total ILEC High Capacity Access Revenue	3,354,451,093
Total ILEC High Cap Zone 1 Access Revenue	845,857,898

Moreover, ILECs have deployed more than one thousand times the amount of transmission facilities than CLECs, more than 18 times the amount of switching facilities than

7 Data from Tariff Review Plans filed by ILECs in support of their 1997 Annual Access Filings.

CLECs, and nearly ten times the amount of fiber than CLECs. These figures, while displaying in stark terms the disparities in network investments, tell only part of the story. ILEC networks are ubiquitous and are capable of reaching every customer with sufficient capacity to handle more than 100 percent of today's telecommunications traffic.[8] It should come as no surprised that, even among the Regional Bell Operating Companies' (RBOCs'), the group of ILECs most likely to be subject to competitive entry due to their operation in the nation's most urban areas, market share of switched access lines is approximately 99 percent in every region of the country.

Table 4. ILEC Market Share Based on Access Lines[9]

	1996	1997
AIT	99.40%	99.13%
BA	99.32%	98.99%
BS	99.45%	99.08%
SBC	99.56%	99.07%
USW	99.63%	99.00%

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8 For example, ILEC networks today contain extensive dark fiber that can quickly and easily be lit for additional capacity.

9 Based on MCI market research. MCI market data was obtained from government documents, industry reports, interviews with leading industry analysts, and MCI internal information. Sources included, but were not limited to: FCC data, International Data Corp, The Gartner Group, DataQuest, Frost & Sullivan, Bear Stearns, Prudential, Salomon Bros., Goldman Sachs, Connecticut Research & New Paradigm Group, CLEC public records, announcements and filings Annual Reports, 10K reports, and 10Q reports filed with the Securities & Exchange Commission.

Even in business markets, where ILECs claim they face the most competitive pressure, CLEC share of business lines, excluding resale, is less than two percent.[10]

	Number	Market Share
1997 ILEC Business Lines[11]	50 million	98.3%
1997 CLEC Business Lines[12] (excluding resale)	867,000	1.7%

In addition, MCI's examination of exchange and exchange access markets has revealed that less than 0.33 percent of all commercial buildings, and 0.01 percent of all residential homes and commercial buildings are located on CLEC networks.[13] The limited local reach of CLEC networks is confirmed in looking at revenue data. It is all too evident that "market forces" cannot be counted on to bring access rates down to cost at any time soon. In fact, so-called "market forces" are not likely to even begin to bring access costs down at any time soon.

There is no prospect that market forces will discipline access charges to any significant degree between now and 2001, the year the Commission stated it would review its access reform

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10 Resold ILEC lines are not included in CLEC market share for this report because ILECs continue to receive access revenues for lines resold by CLECs. Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC Docket No. 96-98, First Report and Order, 11 FCC Rcd 15499 (1996)(Local Competition Order), at ¶980 Order on Reconsideration, CC Docket No. 96-98, 11 FCC Rcd 13042 (1996), petition for review pending and partial stay granted, sub nom. Iowa Utils. Bd. v. FCC, 109 F.3d 418 (8th Cir. 1996).

11 1997 Statistics of Communications Common Carriers, Common Carrier Bureau, Federal Communications Commission, December 5, 1997, Table 2.10.

12 Based on MCI market research.

13 Based on MCI market research.

plan.[14] The Commission's decision to adopt the market-based approach was based on a predictive judgment that competition would develop sufficiently to constrain access charges.[15] Events of the past year, however, have undermined all of the assumptions upon which this predictive judgment was based.

First, shortly after the Commission adopted the Access Charge Reform Order, the 8th Circuit struck down the Commission's pricing guidelines for unbundled network elements. In the Access Charge Reform Order, the Commission had concluded that the Act's cost-based pricing requirement for unbundled network elements would "greatly facilitate competitive entry into the provision of all telecommunications services" and would consequently drive interstate access prices to competitive levels.[16] In many states, however, the current levels of recurring and, in particular, nonrecurring charges for unbundled network elements (UNEs) do not allow for competitive entry. Without both recurring and nonrecurring charges at forward-looking economic cost, the Commission's fundamental assumption that the availability of UNEs could discipline ILEC access charges has been seriously undermined.

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[14] Access Charge Reform Order at ¶48 ("Where competition has not emerged, we reserve the right to adjust rates in the future to bring them into line with forward-looking costs. To assist us in that effort, we will require price cap LECs to submit forward-looking cost studies of their services no later than February 8, 2001, and sooner if we determine that competition is not developing sufficiently for the market-based approach to work.")

[15] See Brief for Federal Communications Commission, Southwestern Bell Telephone Co. v. Federal Communications Commission, Case Nos. 97-2866/2873/2875/3012 (8th Cir.), October 16, 1997 at 98.

[16] Access Charge Reform Order at ¶262.

More recently, the 8th Circuit struck down the Commission's requirement that ILECs combine unbundled elements for new entrants. Without a requirement that the ILECs combine network elements, the scope for UNE-based competition is sharply limited. As the Commission concluded in the Local Competition Order, "requesting carriers would be seriously and unfairly inhibited in their ability to use unbundled elements to enter local markets" if the ILEC is not required to combine elements.[17] The 8th Circuit's decision destroys, for example, the viability of the so-called "platform" approach, which was a key strategy for new entrants to use in entering new markets or expanding their presence in a market. The availability of the platform strategy was an important factor underlying the Commission's "confidence" that unbundled elements could be counted on to constrain the pricing of access services.[18]

When Congress decided to subject all telecommunications markets to competitive forces, it sought to mimic in the local exchange and exchange access markets the successes that competition has brought to the long distance and customer equipment markets, including consumer welfare gains in pricing, improvements in quality, and the ability to choose a service vendor. From the perspective of an IXC, this public policy would benefit its customers in significant ways. The elimination of above-cost access charges helps fuel downward pressure on long distance rates.[19] It also helps to free the long distance industry to compete in local markets -

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17 Local Competition Order at ¶293.

18 Access Charge Reform Order at ¶¶32, 340.

19 The competitive nature of the long distance market is the other major driver of falling prices. See also, Declaration of Robert E. Hall, In the Matter of Applications of WorldCom, Inc., for Transfer of Control of MCI Communications, CC Docket No. 97-211. Also, letters from MCI, AT&T, and Sprint detailing that long distance rates are falling further and faster than access

- cash spent on unnecessary access expense can be diverted into capital to support local initiatives. Indeed, viewed from this perspective, above-cost access is just another barrier to local entry.

While it is apparent that the pathways to creating vigorous competition in the local exchange market have been obscured by ILEC anticompetitive and litigious conduct, the Commission has the unassailable legal authority to produce a pro-competitive result in the exchange access market by prescribing rates to cost. The Communications Act does not enshrine embedded cost as the method of setting interstate access rates. The Commission has the ability to change costing methodologies.[20] All that is required is that the Commission provide a reasoned explanation for its change in policies and that the end result be just and reasonable.[21] In this case, the Commission has the most compelling reason of all -- a Congressional mandate, delivered in

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reductions mandated by the Commission. Letter from Jonathan B. Sallet, Chief Policy Counsel, MCI Communications, to Chairman William Kennard, Federal Communications Commission, March 2, 1998; Letter from Mark C. Rosenblum, Vice President - Law & Federal Government Affairs, AT&T, to Chairman William Kennard, Federal Communications Commission, March 5, 1998; Letter from J. Richard Devlin, Executive Vice President, General Counsel and External Affairs, Sprint, to Chairman William Kennard, Federal Communications Commission, March 4, 1998.

20 Local Competition Order at ¶736 (citing Duquesne Light Co. v. Barasch, 488 U.S. 299, 301-02 (1989)(upholding change in ratemaking methodology that resulted in exclusion of prudently incurred historical costs). Additionally, the Eighth Circuit's reversal of the Local Competition Order explicitly avoided any judgment on the merits of the Commission's pricing methodology. See Iowa Utilities Bd. v. FCC, 120 F.3d 753, 800 (8th Cir. 1997).

21 Illinois Bell Tel. Co. v. FCC, 911 F.2d 776, 780 D.C. Cir. 1990) (upholding order modifying rules for determining rate base that was alleged to have deprived carriers of reasonable return on investment).

the form of the Telecommunications Act of 1996, to promote competition in all telecommunications markets.

II. Forward-looking Economic Costing of Access Is Required as a Matter of Competition Policy and as a Matter of Law

The requirement of the Telecommunications Act of 1996 to make universal service subsidies explicit caused the Commission to initiate interstate access reform.[22] As a result of universal service subsidies being implicitly recovered through access charges, rates for interstate switched access are at least six times economic cost, and the existing rate structure provides a subsidy flow from high volume users to low volume users of telecommunications. In the months leading up to the decision, interexchange carriers (IXCs) joined with large business users and consumers to demand that the Commission bring access prices to cost.

The Commission, however, chose a different path. First, it restructured rates to: (1) place more costs directly on end users in the form of higher subscriber line charges; and (2) recover costs that do not vary with volume, using flat monthly charges instead of per minute charges. Second, the Commission voted to decrease rates by $1.7 billion, far short of the amount needed to bring rates to cost. In so doing, the Commission decided to rely on emerging competition in local telecommunications markets, spurred by the adoption of the 1996 Act, as the driver of reductions in the rates for interstate access services. The Commission left open the possibility that it may re-examine its access policies and reevaluate its reliance on market forces if it determines that competition in the interstate access services market develops more slowly than it

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22 See Access Charge Reform Order at ¶¶3-5.

expected. As is demonstrated in this report, a vibrant competitive market for access has yet to emerge, and downward competitive pressure on ILEC access charges is nonexistent.

A. Forward-looking Economic Cost For Access Is Required as a Matter of Competition Policy

In 1984, the Commission established the current access charge regime.[23] The charges were based on the embedded, fully distributed costs of the incumbent LECs and were designed to compensate the local monopoly for use of their facilities. With the 1996 Act, the policy has changed, as the Commission itself recognized in the Access Reform Order.

Access prices that are substantially above cost will distort markets and investment and harm consumers and competition. The Commission has long recognized that above-cost interstate access prices have forced interstate toll prices to be substantially higher than they would otherwise be, and that they have caused inefficient bypass using dedicated access.[24] First, inflated access charges will retard the development of local competition and will create incentives for inefficient investment in facilities and equipment used for both local exchange services and switched exchange access. The existence of the huge access revenue stream will increase further the incentive of ILECs to frustrate entry and competition by denying new local carriers the interconnection, access, and resale arrangements to which the Act entitles them.

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[23] In the Matter of MTS and WATS Market Structure, Third Report and Order, CC Docket No. 78-72, Phase I, 93 F.C.C. 2d 241 (1983).

[24] High switched access charges induce interexchange carriers to use lower-priced, but higher-cost, dedicated access even when switched access would be less expensive if it were priced at cost. This is true whether dedicated access is provided by ILECs or by competitive access providers.

Moreover, to the extent that ILECs provide interexchange service, high access prices will give them more ways to respond anticompetitively to services offered by new local competitors. High access charges would permit the ILECs to use their pricing of interexchange services to deter entry and investment by competing local carriers.

Second, the ILECs could exploit in the long-distance market their cost advantage derived from access overcharges. ILECs would have this advantage over unaffiliated toll carriers that are equally or more efficient. For example, ILECs can effectively increase the costs of unaffiliated toll carriers by inducing them to choose alternative access arrangements for which the carriers pay less but which have higher economic costs than those self-supplied by the ILECs. These tactics compound the problems created by the ILECs' ability to raise rivals' costs through non-price discrimination. Rather than requiring IXCs to line the pockets of their largest competitors (monopoly ILECs), immediately lowering access to forward-looking economic cost would allow IXCs to increase their investment in local facilities.

As Dr. Daniel Kelley points out in the attached declaration,[25] lowering access charges to forward-looking economic cost increases consumer welfare. High switched access charges promote service bypass of the local exchange and provide false signals to facilities-based entrants. If switched access were priced at cost, the expense of providing dedicated connections to customers who could be served more efficiently on the switched network could be avoided.

MCI estimates that the average long distance customer is paying approximately $7.58 per month too much for long distance service, which goes to line the pockets of the incumbent

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[25] See Appendix B.

LECs.[26] Any approach to reform that permits the incumbent LECs to continue to receive these uneconomic subsidies would certainly fail the Act's public interest test as well as the requirement that rates be just, reasonable and affordable.[27] The Commission must eliminate this excess immediately through the use of a prescriptive approach to achieve Congress' goal of effective competition in the local market.

In the past, an argument could be made that while excessive access charges were unfair, they had no anti-competitive effect because the incumbent LECs could not provide competitive long distance services. Today, however, the competitive threat is clear. If access remains above cost, MCI and the other long distance carriers will be subsidizing the business of their sometime-to-be rivals, the ILECs.[28] Unless the Commission eliminates excessive charges, the incumbent will be able to use them to solidify their control over their local markets or subsidize their entry into long distance. Either outcome will seriously undermine the pro-competitive and pro-consumer goals of the law.

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26 The $7.58 tax was derived by dividing $10 billion of excessive costs by 110 million long distance customers, then dividing the sum by twelve months.

27 47 U.S.C. 201(b); See also, 47 U.S.C. 251-52; 254(b)(5) and 254(k).

28 This is not a theoretical concern. NYNEX's so-called "snow bird" advertising which offered a lower calling rate for calls from Arizona to New York (13 cents /minute) than from Arizona to Nevada (17 cents/minute) demonstrates precisely how the Bells will use inflated access charges to their unfair advantage. See Arizona Republic (p A10) and Phoenix Gazette, Monday, September 9, 1996.

B. Forward-looking Economic Costing for Access Is Required as a Matter of Law

The law requires that the Commission ensure rates are just and reasonable[29] and that all implicit subsidies be made explicit.[30] Once the hidden subsidies to support universal service are made explicit as required under the 1996 Act,[31] there is absolutely no legitimate reason to permit the incumbent LECs to charge above the forward-looking economic cost for access. Any access charges that remain above cost will plainly violate the Act's requirement against subsidies since the amount by which access remains above-cost can only be an unlawful implicit subsidy to ILECs and their shareholders.

The Commission has embarked on a series of actions designed to identify, and make explicit, those subsidies needed to provide affordable local service rates in high cost areas.[32] According to the Commission's proposed calendar for decision-making, that new universal service subsidy mechanism will be in-place on January 1, 1999. MCI estimates that the national subsidy needed to create affordable rates under the Commission's definition is $2.6 billion. Under the current 25/75 federal-state allocation of subsidy burden, approximately $0.65 billion in current interstate access is needed to fund universal service, exclusive of funds created on January 1, 1998 for other purposes. Sizing the universal service fund will remove the last fig leaf

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29 Id.; See also, 47 U.S.C. 205(a).

30 1996 Act at §254.

31 47 U.S.C. 254(b)(5).

32 In the Matter of Federal-State Joint Board on Universal Service, Report and Order, CC Docket No. 96-45, released May 8, 1997.

from the ILEC access charge debate. It will confirm that almost all of the ILECs' above-cost pricing is nothing more than an unlawful implicit subsidy to the ILECs and their shareholders.

III. Absence of Exchange Access Competition

The Access Charge Reform Order contains strikingly little analysis of the "market" for exchange access. But the Commission clearly assumed that "exchange access competition" was a natural byproduct of local exchange competition: exchange access rates would be driven down as CLECs won local exchange customers.[33] In the Commission's view, as competitive entry became increasingly possible, IXCs could either "enter the local market themselves, thereby self-providing interstate access services for their new local exchange customers" or "seek out competitive providers of comparable services."[34] Incumbent LECs, the Commission believed, would then have to respond with lower-priced access services of their own.[35]

However, two years after the signing of the Telecommunications Act, competition in the local telecommunications market has not taken widespread root. By any measure, whether it be by access lines (either through unbundled network elements or through CLEC built facilities), number of CLEC customers, possible CLEC reach through collocation, or even by revenue, CLEC market share for access services is insufficient to place downward pressure on ILEC

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33 Access Charge Reform Order at ¶32 ("The 1996 Act removes barriers to entry in the local market, generating competitive pressures that make it difficult for incumbent LECs to maintain access charges above economic cost.")

34 Access Charge Reform Order at ¶265.

35 Id.

access charges, as the Commission had predicted last year in the Access Charge Reform Order. In fact, as recently as January 2, 1998, FCC Chairman Kennard stated:

> ...the fact remains that in this country, consumers do not have a choice in residential telephone service....[36]

Consumer groups, too, have voiced their concern over the limited presence and slow development of local competition. On December 9, 1997, in a petition filed at the Commission requesting that the Commission prescribe lower access charges, the Consumer Federation of America, the International Communications Association, and the National Retail Federation wrote:

> It is clear that meaningful levels of local telephone service competition will not develop in the foreseeable future...appellate rulings undermine the Commission's efforts to establish the basic elements of local competition, including...reasonable access to unbundled network elements.[37]

Additionally, Martin Cohen of the Illinois Citizens' Utility Board stated on January 3, 1998 that:

> We already have competition in long distance, but there is no competition for local residential phone service and that's where most people spend the most money and would welcome lower prices.[38]

Based on the information and analyses below, MCI demonstrates that a year's worth of evidence now makes undeniable the view that it is time for the Commission to abandon its

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[36] FCC Chairman William Kennard, Reuters, January 2, 1998.

[37] In the Matter of Consumer Federation of America, International Communications Association and National Retail Federation Petition Requesting Amendment of the Commission's Rules Regarding Access Charge Reform and Price Cap Review For Local Exchange Carriers, RM No. 9210, December 9, 1997

[38] Martin Cohen, Illinois Citizens' Utility Board, Chicago Tribune, January 3, 1998.

reliance on market forces to curb monopoly ILEC access profits, and immediately prescribe access rates that reflect forward-looking economic cost.[39]

A. Overview of the Exchange Access Markets

Recently, the Commission has begun to use antitrust market analysis to evaluate competition in markets.[40] To determine relevant product markets in this context, the Commission must consider whether, if, in the absence of regulation, ILECs raised the price of a particular access service or group of services, customers would be able to switch to a substitute service offered at a lower price.[41] In the LEC In-Region Interexchange Order, the Commission observed that for the purpose of analysis, it could aggregate separate product markets for which customers face the same competitive alternatives.[42] Based on this criteria, there is no difference in exchange

39 See Appendix C for quotes of additional quotes of policy makers, regulators, and industry experts on the status of local competition.

40 Typically, the Commission has followed the approach taken from the LEC In-Region Interexchange Order in defining relevant product and geographic markets Regulatory Treatment of LEC Provisions of Interexchange Services Originating in the LEC's Local Exchange Area, Second Report and Order, CC Docket No. 96-61, FCC 97-142, 1997 WL 193831 (rel. April 18, 1997).(LEC In-Region Interexchange Order). That approach is also consistent with the 1992 Merger Guidelines, which state that "market definition focuses on demand substitution factors,..i.e. possible consumer responses." See United States Dep't. of Justice & Federal Trade Comm'n, 1992 Horizontal Merger Guidelines, 57 Fed. Reg. 41552, 41554-41555 §§1.0-1.2 (1992)(1992 Horizontal Merger Guidelines).

41 LEC In-Region Interexchange Order at ¶28, See 1992 Horizontal Merger Guidelines, 57 Fed. Reg. at 41554 § 1.11 (the relevant product market is "a product or group of products such that a hypothetical profit maximizing firm that was the only present and future seller of those products ('monopolist') likely would impose at least a 'small but significant and nontransitory increase in price.")

42 LEC In-Region Interexchange Order at ¶42.